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Economic Conditions
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General Business Conditions

THE reports from business during February have been much the same as in the previous month, with little significant change either in new orders or in the level of industrial operations. As a rule the first quarter of the year is expected to bring a considerable increase in manufacturing activity, in preparation for Spring needs; but the rise in production during the second half of 1938 was so spectacular, particularly in goods of everyday use, that the seasonal requirements are being satisfied for the most part without further increases in output.

Some of the industries, especially those connected with building, report improvement. Steel mill operations, however, have not made all of their normal gain, and textiles and automobiles, which led the upswing last Fall, were already giving as much support to the situation as could reasonably be expected until the recovery in employment and purchasing power is more general. This will require the spread of the improvement more widely through the economic system, and especially in the capital goods industries. The industries cannot support themselves separately. They must go forward together, since the production of each supplies the buying power for the others.

In terms of the seasonally adjusted indexes, which measure industrial production against the seasonal expectation, the trend has been downward. The Federal Reserve Board's index, according to preliminary figures, will show another moderate decline for the month, after dropping from 104 in December to 101 in January. However, the drop reflects only the failure to make normal gains. Cases of actual curtailment are few. The chief instances where production outran the markets during the upswing are in copper and cotton print cloths. Copper output was reduced some weeks ago, and print cloth curtailment now seems to be setting in, under pressure of unprofitable prices.

Business Marking Time

Considered as a whole, business evidently is in a period of marking time and minor adjustments. Business men are conservative, both in buying commodities and in planning for expansion or new projects. Nevertheless, the evidence of the markets and general testimony both indicate that sentiment is better than it was in January. When the check to the upswing became plain early in the year, it was interpreted pessimistically in some quarters; and naturally the apprehensions aroused were strengthened by the rising tension in Europe, by the reaction in security prices in the principal markets, and by the action of Great Britain in taking further measures to support the pound sterling. However necessary that action, it was interpreted as an indication of the continuing disorder in world conditions and the uncertain outlook for trade.

During the past month, however, these apprehensions apparently have been receding. Business men have had time to consider all the elements in the situation, and are taking the flattening out more as a matter of course, naturally to be expected after seven months of uninterrupted expansion. The reasons for confidence in the outlook for Spring are impressive. One of the chief ones, which minimizes the danger of a slump, is that the upswing has not been pushed to extremes by speculation. With the favorable prospect for building, and Government spending still to reach its peak, it is hard to justify expectations that the slackening will either last long or reach serious proportions, and business men generally take a hopeful view.

Moreover, some of the February figures have turned out better than the pessimists anticipated. Both commodity and security markets have strengthened moderately. There were fears in the steel trade that ingot output would fall below 50 per cent of capacity at some time during the month, but in fact the trend has been upward with gains in each week but one; and according to the weekly reports of the Iron and Steel Institute operations have averaged 54 to 55 per cent. New business has been sluggish and mills would like to have a better backlog for March, but the situation seems in good order, and scrap prices have advanced.

Another apprehension was that automobile sales would suffer from the unsettlement. According to preliminary reports, however, they have not varied much from the seasonal expectation since December, which was a good month. Assemblies have been held above sales again in February, for the purpose of evening factory schedules through the Spring, and March therefore may not show as much gain in production as usual.

Department store sales, which were disappointing in January and early February, especially in the Eastern cities, picked up in the middle of the month. Chain and mail order sales were good in January, uniformly showing gains over last year. January farm income was above a year ago, though only because of larger Government payments.

Reports of this kind hardly accord with fears of a slump, and some of the January disappointment therefore has passed off. Moreover, the European tension has relaxed somewhat; and it is likely that there is less fear than heretofore of an outbreak of war in 1939. The improvement in the London stock market has been impressive. While stock prices in this country recovered sharply after the September crisis, the London market had continued depressed, and toward the end of January almost duplicated the September lows. Since then there has been a sharp recovery to new highs since last Fall; and sterling also is the highest of the year. As alarm has diminished in London it has also subsided here.

Outlook in Capital Goods

Developments bearing upon the prospect for a resumption of private investment and capital expenditure in this country have been moderately encouraging. All analyses agree that this is the key to the business outlook. The main cause of the flattening out at the year-end was that the rise in production of goods of everyday use had caught up with current needs, while the capital goods industries, which are dependent upon the spending of business, were not ready to join the circle and carry on the improvement.

Business has opened the year with a mind to conserve its resources and to proceed cautiously with new plans and projects. There are indications that many important corporations, particularly those which did a good deal of replacement and modernization during 1937, do not plan to spend as much on new construction and equipment this year as they did in 1938.

Nevertheless, the improvement that is appearing in some of the capital goods markets is far from negligible. Orders for electric equipment have picked up since the first of the year, both General Electric and Westinghouse reporting substantial increases above a year ago. Machine tool orders have continued to rise; January carried the December improvement forward to a modest extent, and buying has been active during February also. The railroads have been placing considerably more orders for rails than last year, and there is some pickup in buying of other equipment. If the improvement in railway earnings comes up to current expectations the roads will be in the market for considerably more equipment next Fall.

The electric power industry has been heartened by the completion of negotiations for the purchase of certain of the Commonwealth & Southern properties by the T.V.A., on terms which are considerably more liberal than previously offered, and which also recognize principles that the industry considers indispensable if it is to go ahead with plans to meet its future requirements in a normal way. What this will lead to in utility construction and equipment buying remains to be demonstrated. Naturally it does not clear up all the restraints, and as before the industry will shape its building plans more with reference to its early needs than to an uncertain future. Nevertheless, it is a development of major importance, which may be a forerunner of other developments.

Revival of Private Investment Is Necessary

Finally, encouragement has been offered to business by public statements which reflect a broader acceptance, among persons in positions of authority or influence, of the principle that revival of private investment is the only means by which economic recovery can be completed and the unemployed put back to work. One of these is the statement of the American Federation of Labor referred to later in this Letter; and others have been made by members of the President's cabinet. Secretary of the Treasury Morgenthau told a press conference that the business man "ought to feel that the Administration wants him to go ahead and take a normal business risk, and that we want him to make money." He said that he sincerely hoped that Congress "will take a careful look at the tax laws to see if there are any deterrents holding business men back from making future commitments".

Secretary of Commerce Hopkins in his Des Moines speech discussed the "widespread lack of confidence" among business men as a "hard, stubborn fact", and in language phrased to convey reassurance. He referred to the T.V.A. settlement, already mentioned, as a demonstration of good will and "a peace that will be a lasting and good peace". He said further:

> With the emphasis shifted from reform to recovery, this Administration is now determined to promote that recovery with all the vigor and power at its command. . . .
>
> It is clear to me that a returning increase in production cannot be accomplished without a substantial increase in private investment. I have tried to indicate tonight that the government is desirous of doing everything it can to create an environment in which private investment is encouraged.

If there had been the time I could have indicated fields other than utilities—such as private housing and railroads—which offer substantial opportunities for the use of capital goods. I say it is our desire to create an environment in which private capital will be encouraged to invest.

Statements accepting the principle that a substantial increase in private investment is indispensable may prepare for policies that will clear the way for it. In themselves such statements are no more than a beginning, but all parties have an equal interest in encouraging enterprise and increasing the incentive for investment. All the progress that has been made in improving the standard of living has been through the accumulation and investment of capital in the production of new things, or in new ways of making old things better and cheaper. The capital goods industries sorely need the help of more business saving and private investment, through plant modernization and expansion; and it is only by the revival of these industries that employment can be restored.

Building Outlook Continues Favorable

The building industry is counted upon to contribute heavily to Spring improvement and the indications since the first of the year have continued favorable. The total of contract awards in January and early February was smaller than in December, but the December totals were swollen by P.W.A. contracts placed ahead of the December 31 deadline. Most of the work on these contracts will be done this year. Moreover, private awards have increased since December, although usually they drop after the turn of the year. As compared with the daily averages for January and February, 1938, this year's total awards were 36 per cent higher in January and 66 per cent larger in the first half of February.

Building trade authorities agree that the construction volume this year should be the largest since 1929 or early 1930. Awards of public works contracts will decline, barring a new program, but private awards are expected to increase more. Most authorities estimate that total residential contract awards this year, public and private, will be at least 30, possibly 40 per cent or more, over last year, and that commercial and industrial building will show increases over the very low levels of 1938. The effectiveness of the Federal Housing Administration's activities continues to be a major stimulus to residential building. So far this year small home mortgages insured and selected for appraisal have continued on a high level, and well above the figures of a year ago.

Money and Banking

The money situation has continued easy, and apparently there is nothing yet in sight to change this condition. Following a rise to a new peak in late January, excess reserves of member banks declined over $400,000,000 by the middle of February, but even at the low point remained well over $3,000,000,000; and in the third week of the month they recovered $130,000,000. The decline, moreover, was associated principally with Government operations, and hence was of limited significance. Payment of social security taxes and financing by Treasury agencies—the U. S. Housing Authority and the R.F.C.—drew heavily from the market and raised Treasury balances in the Reserve Banks to over $1,000,000,000. Disbursement of these balances will add to money market funds in due course, but the movement will be interrupted temporarily on and immediately after March 15 by collection of income taxes.

Of chief importance in the money situation is the fact that gold is still flowing into the country in volume and adding to the monetary base. During the first three weeks of February our gold stock increased $124,000,000 to a new high of $14,818,000,000. So long as the gold movement continues at the current rate it constitutes a strong force for easy money conditions.

Figures of currency in circulation continue to invite interest by reason of unusual increases being shown. Following a less than seasonal decline after the Christmas holidays, currency outstanding increased more than usual in February and on the 21st was the largest on record for the season, $384,000,000 higher than a year previous. One explanation for the increased demand for currency is the hoarding of United States money by Europeans since the war crisis last September, but of course this does not account for the more or less steady rise of currency in circulation since 1930, regardless of the trend of business. An article in our December issue, commenting upon this increase and suggesting a number of possible explanations, has prompted one of our readers in a small town in Montana to write as follows:

In this part of the country at least, the increase in currency in circulation is due almost entirely to the desire on the part of most every person in debt, particularly the farmers, and that takes in most all the farmers, to conceal their real assets in every way possible, and to their further plans to receive old age pensions at the earliest date, which also, in their opinion, warrants them to carry cash instead of using a bank account; the same theory is also carried out by families who aspire to be on the relief rolls. I believe these are major factors in this particular situation. Anyway, if people generally over the country are being actuated by these desires, as they unquestionably are here in Montana, statisticians need not look for an early return of these funds to banks.

Other developments in the money market may be reviewed briefly. Apart from a rise in holdings of U. S. Government guaranteed obligations, due to new financing by the U. S. Housing Authority and the R.F.C., member bank reports disclosed no outstanding changes during the month. The decline in business loans, however, gave some indications of levelling off, the total on February 21 standing at about the same point as a month earlier.

High grade bonds continued firm at peak prices, in keeping with the general money situation, and Treasury bills remained practically on a no-yield basis. Owing to large cash balances on hand, the Treasury announced that the March 15 financing would be confined to an exchange offering to holders of $1,294,000,000 of notes maturing June 15.

New capital issues by business, totaling $160,000,000 in February, were larger in volume than in January, but the proportion representing new money continued small, about $15,000,000. A number of important issues are reported under consideration, including a $40,000,000 bond issue by the Texas Corp. for new capital purposes.

Profits of Leading Manufacturing Corporations in 1937-38

Annual reports to shareholders published to date by 940 leading manufacturing corporations show combined net profits, less deficits, of approximately $672,000,000 for the year 1938, compared with $1,545,000,000 for the same companies in 1937, — a decline of 56 per cent. These companies had an aggregate net worth of $15,202,000,000 at the beginning of 1938 and $14,705,000,000 at the beginning of 1937, upon which the net profits represented a return of 4.4 per cent and 10.5 per cent respectively.

The outstanding feature of the year's results was the sharp rise in profits that occurred in the fourth quarter, accompanying the upturn in general business activity. A group of 200 large companies, for which regular quarterly figures are available, showed a drop of about 67 per cent in net profits during the first nine months of 1938 as compared with the same period of 1937, but in the final three months, according to preliminary figures, made a gain of 13 per cent, as indicated by the following totals:

Net Profits of 200 Leading Industrial Corporations
(In Millions of Dollars)

	1937	1938	% Change
Net Worth Jan. 1......	$10,615	$11,190	.....
Net Profits			
First Quarter	318	108	—66
Second Quarter	385	118	—69
Third Quarter	324	111	—66
Fourth Quarter	226	255-Pre.	+13

It will be seen that the comparative gain in the fourth quarter was due both to the downward trend in the latter part of 1937, and to the actual increase during the fourth quarter of 1938, when dollar profits were more than double the rate of the preceding three quarters. In fact, many individual companies, notably in the automobile and steel industries, secured the major portion of their last year's earnings in the final three months.

Changes in Different Industries

The accompanying summary of our tabulation of reports of leading manufacturing corporations shows, by industrial groups, the number of companies and their combined net profits for the years 1937-38, also the net worth and the annual rate of return. This year the arrangement of the summary has been changed so as to bring together the principal and related branches of each industrial division, as given in the Treasury Department "Statistics of Income," instead of listing the classifications in alphabetical order. The composition of the different groups and sub-groups is substantially the same as in prior years.

While the reports now available for leading corporations, taken as a whole, show a decline in profits of 56 per cent last year, an examination of the summary will reveal the highly uneven character of the changes among different industries. About one-third of these leading companies reported net deficits in 1938, whereas only one-ninth were in the red in 1937.

On the other hand, numerous companies in the baking, beverage, miscellaneous food products and aircraft industries reported increased profits last year, due to lower costs for raw materials or an expansion in sales. Certain other companies in scattered lines also were able to increase their profits, — some by improved operating efficiency and others by the development of new products.

In most lines, however, the contraction in sales volume last year forced a sharp decline in profits or created net deficits. The important metal, machinery, equipment and automobile industries were particularly hard hit in this respect. Other factors tending to narrow profits were the further increase in wages and shortening of hours last year, and the rise in some forms of taxes, including the payroll levy for unemployment insurance.

1938 Inventories Down 12 Per Cent

Still another adverse influence upon business profits last year was the decline that occurred in commodity prices. This necessitated heavy writing-down of inventory valuations at the year-end in a number of industries accustomed to carry large stocks of materials, such as meat packing, leather and shoes, petroleum, and various textile and metal products.

An analysis of the year-end balance sheets of 300 large manufacturing and trade corporations, having inventories of $1,000,000 and upwards, shows that last year their combined inventories, at dollar value, declined from $2,432,000,000 to $2,130,000,000, or by 12 per cent. Retail sales of all kinds in 1938 also declined by about 12 per cent, according to a preliminary survey of the Department of Commerce, against a decline in manufacturers' sales of 17 per cent. This permitted considerable work-

ing down of inventories by manufacturers and distributors. Changes by major industrial divisions are given in the accompanying table.

Inventories of Leading Corporations, 1937-38
(In Millions of Dollars)

No.	Manufacturing	End of Fiscal Year 1937	1938	Percent Change
27	Food products	$408	$353	—13
12	Tobacco products	356	368	+ 3
31	Textile mill products	124	104	—16
12	Clothing and apparel	34	23	—32
16	Leather and shoes	103	83	—19
8	Rubber products	145	116	—20
6	Wood products	12	11	— 8
17	Paper products	46	43	— 7
21	Chemical products	163	141	—14
5	Petroleum products	59	62	+ 5
9	Stone, clay and glass	47	39	—17
85	Metal products	582	480	—18
9	Motor vehicles	75	67	—11
8	Misc. mfg.	48	43	—10
266	Total mfg.	2,202	1,932	—12
	Trade			
20	Retail	172	149	—13
14	Wholesale	59	49	—17
34	Total trade	230	198	—14
300	Total mfg. and trade	$2,432	$2,130	—12

Because of the decline in commodity prices last year, the decrease of physical stocks was somewhat less than that of dollar valuations. The net effect of price changes upon inventories and profits, however, cannot be measured accurately, since the year-end inventories are a mixture of raw materials, goods in process and finished merchandise, acquired or produced at different dates, and at varying purchase prices or production costs. Moreover, a limited sample such as the above provides only a rough indication of trend; it is overweighted by the tobacco group, reflecting the large tobacco crops of the past two years, and does not include most of the large petroleum companies, nor numerous other large organizations, whose detailed reports for 1938 have not yet been issued.

Nevertheless, a net reduction of 12 per cent in inventories by this group has significance in the business outlook, for it shows progress toward correcting the excessive stock situation in some lines built up in 1936-37, and suggests that manufacturers' employment and purchases of materials should be maintained at a higher rate this year than would otherwise be the case.

1938 Dividends Down 35 Per Cent

Last year the cash dividends declared by leading manufacturing corporations, as compiled by the New York Times and given in the accompanying table, amounted to approximately $1,818,000,000, compared with $2,817,000,000 in 1937 and $2,498,000,00 in 1936.

Reductions in dividends were reported by 554 companies in 1938, as against only 112 in 1937, while there were omissions by 652 companies, as against only 106. Last year the trend of dividends was somewhat similar to that of

Cash Dividend Declarations in 1937-38
(In Millions of Dollars)

Groups	1937	1938	% Change
Food and packing	$191	$163	—15
Motor vehicles	233	93	—60
Motor equipment	100	35	—65
Petroleum	472	356	—25
Railroad equipment	48	18	—63
Steel and iron	154	53	—66
Tobacco	100	94	— 6
Miscellaneous	1,519	1,008	—34
Total	$2,817	$1,818	—35

Source: New York Times tabulation of all declarations publicly reported, other than the railroad, public utility, mining, trade, bank and insurance groups.

profits, with the smaller reductions taking place in the tobacco and food products industries, and the larger in the metal, heavy equipment and automobile industries. Total dividends, however, declined considerably less sharply than did profits, and many companies which maintained preferred or common dividends took part or all of such payments from surplus rather than current earnings.

It is of interest to find that wage payments in the manufacturing industries declined by only 24 per cent last year, according to the payroll index of the Bureau of Labor, against declines of 56 per cent in profits and 35 percent in dividends shown by leading companies.

Depletion of Industrial Capital

Since 1929, the total of cash dividends paid out by manufacturing corporations has greatly exceeded their net income, and there has been a large contraction of capital funds invested in these industries.

Income, Taxes and Dividends of All Manufacturing Corporations in the U. S.
(In Millions of Dollars)

Year	Gross Oper. Inc.(a)	Federal Income Taxes(b)	Other Taxes Paid(c)	Total Taxes Paid	Net Inc. After Tax(a)	Cash Dividends Paid(d)	Balance to Surplus
1927	$ 63,439	$ 508	$ 557	$1,065	$2,673	$2,226	$ 447
1928	66,898	545	573	1,118	3,460	2,507	953
1929	71,640	544	617	1,161	3,954	2,575	1,379
1930	60,428	317	635	952	877	2,613	–1,736
1931	43,716	165	566	731	– 913	1,894	–2,807
1932	31,845	100	547	647	–1,827	1,115	–2,942
1933	35,070	207	646	853	77	1,010	– 933
1934	40,768	266	566	832	778	1,221	– 443
1935	47,334	357	958	1,315	1,509	1,580	– 71
1936	56,431	608	1,040	1,648	2,548	2,404	144
Totals							
1927-29	201,972	1,597	1,747	3,344	10,087	7,308	2,779
1930-34	211,827	1,055	2,960	4,015	–1,008	7,858	–8,861
1935-36	103,765	965	1,998	2,963	4,057	3,984	73
1927-36	$517,564	$3,617	$6,705	$10,822	$13,136	$19,145	–$6,009

Source: Compiled from annual reports on Statistics of Income, Treasury Department. –Deficit. (a) Includes tax exempt interest received, but excludes intercorporate dividends received. (b) Includes federal normal tax, surtax on undistributed profits and excess-profits tax. (c) Includes state, local and other taxes paid, but does not include an unknown amount of taxes that have been reported and tabulated under "cost of goods sold" and "cost of operations" in the returns. (d) Excludes intercorporate dividends paid—assumed to be equal to intercorporate dividends received.

PROFITS OF LEADING MANUFACTURING CORPORATIONS FOR THE YEARS 1937 AND 1938

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Years 1937	Net Profits Years 1938	Per Cent Change	Net Worth January 1 1937	Net Worth January 1 1938	Per Cent Return 1937	Per Cent Return 1938
18	Baking	$ 21,989	$ 24,890	+13.2	$ 272,195	$ 268,476	8.1	9.3
21	Meat packing	18,930	D- 5,707	—......	581,452	570,233	3.3	......
25	Sugar	15,216	4,540	—70.2	200,026	205,507	7.6	2.2
60	Misc. food products	89,790	90,315	+ 0.6	959,706	963,399	9.4	9.4
124	Total food products	145,925	114,038	—21.8	2,013,379	2,007,615	7.2	5.7
34	Brewing and distilling	13,167	12,864	— 2.3	88,716	92,458	14.8	13.9
10	Beverages (non-alcoholic)	3,636	3,683	+ 1.3	16,335	17,320	22.3	21.3
44	Total beverages	16,803	16,547	— 1.5	105,051	109,778	16.0	15.1
17	Tobacco products	67,836	65,143	— 4.0	468,638	470.071	14.5	13.9
36	Cotton goods	11,110	D- 6,981	—......	240,216	218,770	4.6	......
7	Silk and rayon	7,688	3,547	—53.9	82,879	86,081	9.3	4.1
9	Woolen goods	D- 906	D-6,208	—......	96,018	92,934	......	......
19	Knitted goods	3,085	1,699	—44.9	52,161	51,032	5.9	3.3
24	Misc. textile products	16,549	D- 2,674	—......	168,545	166,293	9.8	......
95	Total textile products	37,526	D- 10,617	—......	639,819	615,110	5.9	......
20	Clothing and apparel	4,818	1,965	—59.2	89,259	91,254	5.4	2.2
7	Leather tanning	1,908	D- 4,366	—......	49,068	45,978	3.9	......
16	Shoes, etc.	11,993	6,308	—47.4	171,406	170,111	7.0	3.7
23	Total leather products	13,901	1,942	—86.0	220,474	216,089	6.3	0.9
22	Rubber products	20,444	17,823	—12.8	360,569	361,695	5.7	4.9
28	Wood products	7,859	2,204	—71.9	69,271	73,115	11.3	3.0
42	Paper products	30,608	15,474	—49.4	366,482	380,856	8.4	4.1
21	Printing and publishing	5,946	1,761	—70.4	76,241	77,387	7.8	2.3
24	Chemicals—industrial, etc.	118,319	69,009	—41.7	806,089	887,546	14.7	7.8
16	Drugs	57,006	43,960	—22.9	238,463	250,808	23.9	17.5
8	Fertilizer	5,946	2,782	—53.2	78,851	80,744	7.5	3.4
12	Paint and varnish	17,263	7,234	—58.1	204,512	207,384	8.4	3.5
60	Total chemical products	198,534	122,985	—38.0	1,327,915	1,426,482	15.0	8.6
25	Petroleum products	138,522	69,534	—49.8	1,357,738	1,488,631	10.2	4.7
38	Stone, clay and glass	35,103	20,587	—41.4	381,621	387,372	9.2	5.3
41	Iron and steel	208,668	D- 2,444	—......	3,009,751	3,144,063	6.9	......
11	Agricultural implements	64,218	35,485	—44.7	494,891	522,952	13.0	6.8
26	Building equipment	12,096	672	—94.4	72,224	80,594	16.7	0.8
36	Electrical equipment	64,998	23,632	—63.6	525,824	534,070	12.4	4.4
33	Hardware and tools	21,018	7,889	—62.5	136,630	142,726	15.4	5.5
22	Household equipment	10,123	3,216	—68.2	55,812	58,187	18.1	5.5
71	Machinery	42,422	13,701	—67.7	271,884	297,977	15.6	4.6
11	Office equipment	25,825	16,094	—37.7	120,196	128,973	21.5	12.5
21	Railway equipment	41,713	D- 3,593	—......	623,579	644,129	6.7	......
15	Aircraft and parts	1,986	4,215	+......	50,776	52,153	3.9	8.1
32	Misc. metal products	37,961	22,308	—41.2	363,110	350,108	10.5	6.4
319	Total metal products	531,023	121,175	—77.2	5,724,677	5,955,932	9.3	2.0
19	Motor vehicles (complete)	256,257	106,838	—58.3	1,305,523	1,334,119	19.6	8.0
31	Motor vehicle parts	29,697	3,331	—88.8	145,925	151,349	20.4	2.2
50	Total motor vehicles	285,954	110,169	—61.5	1,451,488	1,485,468	19.6	7.4
12	Misc. manufacturing	4,202	1,416	—66.3	52,410	55,066	8.0	2.6
940	Total manufacturing	$1,545,004	$672,146	—56.5	$14,704,992	$15,201,921	10.5	4.4

D — Deficit.

During the three years 1927-29, these figures compiled by the Treasury Department for all manufacturing corporations in the United States (about 92,000) show that 73 per cent of the net income was paid out in dividends, while 27 per cent or $2,779,000,000 was added to surplus and retained in the business. For the next five years, 1930-34, the net income was offset by deficits, and the payment of dividends —even at greatly reduced rates—caused a draft upon capital to the extent of $8,861,000,000. In 1935-36, the latest date to which complete figures are available, over 98 per cent of profits was paid out in dividends, and only $73,000,000 was carried to surplus.

This failure of business to retain a larger portion of earnings during recent years has been attributed to a number of different causes. First, the surtax on undistributed profits, introduced in 1936, and modified in 1938, placed a heavy penalty on the ploughing back of corporate earnings into current or fixed assets, or

upon their use for retirement of debt. It thus exerted pressure upon directors to distribute a major portion of the earnings, in the years when there were earnings.

Other considerations that have been mentioned frequently as contributing to the withdrawal of capital from business, in place of the investment of new capital for maintenance and normal growth, are the unsatisfactory rate of return (or lack of return) on existing capital, the increased costs and difficulties of doing business, the numerous and high taxes bearing upon corporations and their investors and, finally, the widespread lack of confidence and uncertainty as to the future.

Taxes have become an increasingly important element in the cost of doing business and are entirely beyond the control of management. While some taxes are computed on net income, numerous others are based on sales, payrolls, capital stock, real estate, etc., and must be met even though the corporation has no net income. The ten-year summary shows that $10 in direct taxes was paid by the manufacturing corporations for every $13 of net income remaining to shareholders.

Regardless of the causes for the slowing down of capital investment, the facts are that the long-term upward growth of shareholders' equity in the manufacturing industries was checked in 1930, and has not been resumed. Dividends received by shareholders in recent years have represented, to a considerable extent, not a distribution of current earnings, but a liquidation of capital. Industry today might be likened to a machine, on which the depreciation and obsolescence have been greater than the expenditures for maintenance, repairs and improvements.

Fortunately, there are numerous exceptions to this general trend. Even during the long depression many progressive and efficient corporations have continued to grow and have modernized their equipment, improved their operating efficiency, lowered their selling prices and expanded their volume of sales. The chief problem today is to reestablish conditions under which industrial growth will be the usual, rather than the exceptional thing.

Relations with Latin America

The arrival in this country early in February of a Brazilian mission headed by Dr. Oswaldo Aranha, former Brazilian Ambassador to the United States and now Minister of Foreign Affairs, was an important event in the field of foreign trade and Latin American affairs. While information has been meagre, it is understood that the discussions already begun with the representatives of our Government will cover a broad field of mutual interest, including problems of exchange, trade and national defense. Apart from the exchange problem, of immediate concern to both countries, we have an interest in strengthening our trade position in Brazil which has been threatened in the past few years by barter agreements and more favorable terms offered by totalitarian countries. Brazil, in turn, is interested in obtaining credits for purchase of capital goods for speeding up her industrialization and defense program. Inasmuch as the relations between the two countries have always been cordial and friendly, there is reason to hope that the conferences now under way will yield constructive results.

As regards exchange, Brazil's present difficulties date back to the beginning of the depression when a sharp decrease in the price of coffee, coupled with a suspension of the inflow of foreign capital, caused a marked dislocation in the balance of payments. Eventually it became necessary to stop payment on the foreign debt, of which about $357,000,000 is outstanding in this market, and to institute a rigid control of exchange, with the result that large amounts of foreign funds, including proceeds of merchandise sales and earnings on foreign investments, became frozen within the country. While in recent years considerable progress has been made in liquidating the foreign commercial debt, the situation again took a turn for the worse with the fall in commodity prices in the latter part of 1937 and early part of 1938. At the present time there is a delay of about thirty days before the Brazilian authorities allocate exchange against imports. Even so, this represents an improvement over the situation some months ago, as the trade balance, which was adverse to Brazil at the beginning of last year, has recently become more favorable. Whereas the first quarter of 1938 revealed the unusual condition for Brazil of a surplus of imports, amounting to $19,000,000, subsequent months brought a reversal, caused both by a restriction of imports and expansion of exports, and October ended with a moderate favorable balance for the ten months' period.

Our Trade with Brazil

As evidenced by the accompanying table, Brazil accounts for around 2 per cent, on the average, of our total exports, including re-exports, and from 4 to 6 per cent of our total imports, with the latter percentages tending

United States Exports to and Imports from Brazil
(Value in Millions of Dollars)

	Exports		Imports		
Year	Value	% of U.S. Exports	Value	% of U.S. Imports	% Duty Free
1913......	39.9	1.6	100.9	5.6	99.9
1929......	108.8	2.1	207.7	4.7	97.8
1932......	28.6	1.8	82.1	6.2	97.5
1933......	29.7	1.8	82.6	5.7	96.3
1934......	40.4	1.9	91.5	5.5	96.0
1935......	43.6	1.9	99.7	4.9	91.3
1936......	49.0	2.0	102.0	4.2	89.0
1937......	68.6	2.1	120.6	3.9	87.0
1938......	62.0	2.0	97.9	5.0	

to decrease in recent years. If these figures seem small, it may be well to note that in 1938 Brazil was our sixteenth most important export market, and ranked sixth among the countries from which we draw our imports. It will be seen that the great bulk of Brazil's products are admitted to this country free of duty, comprising, as they do, largely non-competitive tropical products, principally coffee, cocoa and carnauba wax. Recently, however, there has been a tendency for the percentage of duty-free imports from Brazil to decline, due probably to the growing diversification of Brazilian products.

As the table shows, the balance of trade between the two countries runs consistently in Brazil's favor, with the annual excess of our purchases over sales ranging over the past fifteen years from $140,000,000 in 1926 to $36,000,000 in 1938, the latter total being the smallest for the period.

One of the most interesting features of the trade figures has been the evidence supplied of the changing character of the Brazilian economy—the result of efforts to diversify in order to mitigate the loss of coffee markets and lower prices. In our own trade with Brazil, the principal item of import continues to be coffee, but the proportion of other products has been increasing. Thus, nearly 30 per cent now consists of canned meats, hides, carnauba wax, cabinet woods, vegetable oils and nuts and other tropical products, many of which are new to trade and have increased several times in volume. Even greater changes have taken place in our export trade to Brazil. As a result of a rapid growth of Brazilian industries since the depression, the importance in the trade figures of textiles, paper products, cement, leather goods and many other products now manufactured in Brazil has declined. Over half of our total exports to Brazil is now accounted for by motor vehicles and machinery. Another sign of the country's growing motorization and industrialization is our expanding export of petroleum products and coal, and of semi-manufactures and raw materials for further fabrication within Brazil.

In the next table we give a comparison of principal Brazilian exports in 1936 and in 1927, indicating the decrease in the reliance upon coffee over the ten-year period and the rise in the importance of cotton to a value equal to nearly a fifth that of total exports.

Still another factor of our trade with Brazil, to which we referred at the outset and which is occasioning concern among our exporters, is the increasing competition of other nationalities, particularly the totalitarian countries. As the following table shows, our share in Brazilian exports has fallen since 1932 from 45.8 per cent to 32.9 per cent, while during the same period our share in Brazilian imports has dropped from 30.2 per cent to 23.8. Germany, on the other hand, has been increasing her share of this trade, and in 1936 displaced us from our position as the leading supplier of Brazilian imports which we had held since World War years. A factor, undoubtedly, in these changes has been the pressing need of Brazil to find export outlets for many of her new products, including cotton, in order to compensate for the partial loss of her coffee trade. With Germany ready and eager to accept her products on a barter basis, Brazil has been under strong compulsion to satisfy her own import requirements from German sources.

Chief Exports of Brazil
(Quantity and value expressed in thousands)

		1927			1936		
Commodity	Unit	Quantity	Value	% of Total	Quantity	Value	% of Total
Coffee, raw	bag	15,115	$304,954	70.7	14,186	$145,884	45.6
Cotton, raw	lb.	26,271	4,965	1.2	441,610	60,818	19.0
Cocoa beans	lb.	166,542	22,190	5.1	268,844	16,868	5.3
Hides, skins	lb.	141,011	21,306	5.0	127,521	13,651	4.2
Oil seeds	lb.	179,965	8,295	1.9	541,112	12,233	3.8
Meat products	lb.	76,260	6,165	1.3	213,017	11,068	3.5
Oranges, frts.	lb.	168,935	2,295	.5	*	9,913	3.0
Carnauba wax	lb.	15,506	3,748	.9	19,348	6,376	2.0
Rubber, crude	lb.	57,676	13,617	3.2	29,204	4,447	1.4
All other			43,929	10.2		38,785	12.2
			431,464	100.		320,043	100.

* Not available.

Distribution of Brazilian Trade

Per cent of Total Exports

Country	1913	1929	1932	1934	1935	1936	1937	1938 9 mos.
United States	32.2	42.2	45.8	39.2	39.4	38.9	36.2	32.9
Germany	14.0	8.8	8.9	13.1	16.5	13.2	17.0	21.0
United Kingdom	13.2	6.5	7.0	12.1	9.3	11.9	9.1	9.1
France	12.2	11.1	8.9	7.1	8.1	7.4	6.3	6.5
Italy	1.3	4.7	3.7	3.1	2.7	3.3	2.2	1.8
Argentina	4.7	6.4	6.0	4.7	4.9	4.1	4.7	4.2
Japan	—	—	.2	.3	.5	4.3	5.0	4.8

Per cent of Total Imports

Country	1913	1929	1932	1934	1935	1936	1937	1938 9 mos.
United States	15.7	30.1	30.2	23.7	23.4	22.1	23.0	23.8
Germany	17.5	12.7	9.0	14.0	20.4	23.5	23.9	25.1
United Kingdom	24.5	19.2	19.2	17.1	12.4	11.3	14.0	10.0
France	9.8	5.3	5.1	3.6	3.4	2.9	2.4	3.0
Italy	3.8	3.2	4.0	3.5	2.5	1.8	1.5	1.7
Argentina	7.4	10.9	7.4	12.4	12.9	16.4	14.0	13.1
Japan	—	—	.4	.7	.9	1.2	1.6	1.4

A Brazil Five Year Program

Recognizing the weakness of excessive dependence upon one crop — coffee — Brazil has been aggressively promoting local manufacturing and developing new export products, of which cotton has been the outstanding example, the country now ranking as one of the lowest cost producers of the staple in the world and taking fourth place as an exporter. At the same time the coffee situation has improved since the modification of the coffee control policies in November, 1937. With the reduction in the export tax, coffee exports from Brazil increased almost 50 per cent in the past year, which, with the continuance of the destruction program (some 65,000,000 bags have been destroyed since 1931), has placed coffee in the best statistical position in the past eight to ten years. On February 22 the Brazilian Coffee Convention voted to continue the present coffee policy until 1943. The need for a

higher ratio of better quality coffee is generally appreciated, and measures have been adopted to improve the quality of coffee and cotton.

Development of the country industrially, however, has been handicapped by vast distances and lack of adequate transportation facilities, many of the consuming centers having better communication with Europe and North American centers than with the chief Brazilian industrial regions in the State of Sao Paulo. Moreover, there is a lack of exploited natural resources required for basic industries, such as iron and steel, petroleum, etc., although Brazil possesses one of the richest iron ore deposits in the world, and petroleum has been discovered in the State of Bahia.

The Brazilian "Five Year Plan" for economic development, public works improvement and national defense, announced last January, proposes to remedy some of these shortcomings. It contemplates the building up of the navy and merchant marine, creation of an iron and steel industry and the linking of various parts of Brazil by highways and railways. A great highway is to connect the agricultural and raw material producing North with the industrial areas of the South, and a railroad is to link up with Bolivia on the West. Strong efforts are to be made also to increase the production of rubber and wheat. The program is expected to cost $150,000,000, to be expended at the rate of $30,000,000 yearly.

During the past decade exports were the only source of foreign exchange with which Brazil could buy capital goods abroad for her economic development. However, to carry out her new program, Brazil will also need additional credit for purchase of railway material, highway machinery and capital goods in general, and no doubt these requirements are among the subjects under discussion. It would be indeed gratifying to the holder of Brazilian bonds if along with these conversations there should be a resumption of payments under the Aranha plan of debt adjustment, which provided for partial payments of bond interest from 1934 to 1937.

Argentina Moves to Restrict Imports from U. S.

An important development affecting our relations with Argentina was the announcement last month by the Argentine Exchange Control Office that imports from United States will be curtailed in order to reduce Argentina's adverse balance of payments with this country. The Exchange Office for several months has been issuing import permits to individual countries in proportion to Argentine exports, and importers of manufactures from the United States have had to secure to an increasing extent exchange coverage in the free market, which carried first a 20 and then a 10 per cent surcharge over the official rate.

Like Brazil, Argentina has been under pressure to buy manufactured goods from European countries, which absorbed about 75 per cent of her exports in 1938. Argentine sales to this country were reduced from $139,000,000 in 1937 to $41,000,000 in 1938 and represented only 8 per cent of Argentine exports. This was because the competitive character of Argentine products has prevented the development of a wider market in this country except when the drought here necessitated larger imports of grains, meats, hides and wool.

On the other hand, we supplied Argentina in 1938 with nearly 18 per cent of her import requirements, or almost as much as the United Kingdom, her best customer, which took 32 per cent of her exports. Argentina bought here mostly manufactured articles and was in 1938 our best Latin American market. In 1937 she imported 27 per cent of our total exports of automobiles and was our second largest market for agricultural machinery.

As a result, Argentina has had adverse trade balances with us ever since the War, with the exception of 1923, 1935, 1936 and 1937. In addition, Argentina has met annually large sums on account of debts outstanding here.

Because of the sharp fall in prices and small crops, Argentine exports were disappointing in 1938, falling 50 per cent in volume and 39 per cent in value below 1937. With the adverse trade balance of 61,000,000 pesos the country had to borrow abroad and draw on foreign exchange balances as well as gold accumulated in the prosperous year 1937 in order to pay 300,000,000 to 400,000,000 pesos required to balance her international accounts. The prospects for the year 1939 are better in view of a wheat crop which is the second largest on record, and about normal corn and linseed crops. However, the wheat crop has been moving out slowly and at lower prices as a result of large excess supplies in world markets. The Argentine Government is guaranteeing the price to the farmer. Foreign exchange stringency has apparently continued and has led to the steps taken last month.

Organized Labor and Agriculture

Two notable events of the past month were a formal statement by the Executive Council of the American Federation of Labor, closing its mid-winter meeting at Miami, and a meeting of the Farm Institute at Des Moines. The A. F. of L. statement was a full and evidently carefully considered utterance, unequivocal on vital questions and directed mainly to the problem of unemployment. Early in the statement its principal conclusion is announced in the following language:

> We are firmly convinced that various forms of government spending, either in the distribution of relief or in the development and maintenance of work projects designed to supply relief wages to unemployed, can only serve as temporary measures and cannot and do not provide a permanent solution for unemployment.

It takes a firm stand against the apparently spreading idea that the nation has a permanent body of unemployed, and can do nothing but provide governmental "relief":

We do not believe that the nation has reached the maximum in production or consumption of manufactured goods. For that reason we cannot accept the reasoning of those who maintain that we must prepare to maintain constantly an army of unemployed as the wards of the government. We must turn to private industry for the solution.

The address recognizes that after ten years of disorder and depression, with heavy losses, confidence must be restored before the spirit of enterprise can be revived. It says:

A political and economic state of mind should be created which would enable all financiers and the owners and management of industry to face the future with confidence, willing to risk in the expenditure of funds for the development of industrial enterprise and in the manufacture and sale of manufactured products.

And near the end, it says in sweeping terms:

The executive council reaffirms the position of the American Federation of Labor, regarding private enterprise and private initiative. We are firmly committed to such an economic philosophy. We believe that private initiative, private investment and private endeavor in private industry should be encouraged and supported. We assert that those who invest in private industry should earn a fair return upon such investment and that labor should be paid a fair wage which would accord to all workers and their families an opportunity to live in decency and comfort.

We urge the development of the highest and most perfect form of cooperation between management and labor.

Finally, it points out that if its ideas are accepted, the spending of millions of dollars for relief will be unnecessary, and can be saved for other purposes. It says:

If the unemployed could be accorded the opportunity to work in private industry the spending of millions of dollars for relief purposes would cease. This would mean that the burden of taxation could be reduced and the national income increased. The spirit and morale of the unemployed workers would be lifted to a higher basis.

The statement throughout is in accord with those quotations, and pledges cooperation with all efforts to increase employment in private industry. The temper and breadth of view point the way to a solution of present problems.

The Farm Institute

The Farm Institute meeting at Des Moines was one of a series sponsored by farm leaders, to which labor leaders, industrial leaders and government officials have been invited for conference on the "general welfare." Secretary Wallace was there and spoke for an inter-group council of agriculture, labor and industry to work with the Government for "economic reconstruction." Mr. Charles R. Hook, President of the American Rolling Mill Company and Chairman of the Board of the National Association of Manufacturers, said that industry was not stopping with a public offer to "cooperate with agriculture, labor, government, or any one else," but was "working internally to contribute every ounce of its resources and power to the battle for national well-being."

Miss Frances Perkins, Secretary of Labor, praised the wage and hour law, and is quoted as saying that an increase of one dollar a day in the incomes of the low-wage groups would set all the industries humming.

Mr. Sidney Hillman, Vice President of the C. I. O., urged farmers to "drop their traditional distrust of industrial labor." He said that "the processes of economic democracy require cooperative action by responsible representatives of well organized groups," and that "no program of reconstruction can succeed today without the assistance of the government."

Mr. Joseph B. Eastman, of the Interstate Commerce Commission, made a useful talk on the plight of the railroads, saying that "the best hope lies in improving the economy and efficiency of their operations and giving a service which both in price and quality will stimulate the greatest possible demand,"—which is sound policy for every business. He said:

When farmers and the railroads clash over freight rates, as they often do, it becomes a case of a controversy with both parties afflicted with poverty.

It is not a case of saving the under dog from the top dog, but of attempting to mete out justice as evenly as we can between two under dogs.

Mr. Edward A. O'Neal, President of the American Farm Bureau Federation, affirmed that the free flow of goods and services had been seriously curtailed by inflexible prices and wages, maintained by purely artificial factors.

The press report says that he "challenged labor to adopt a wage scale that would permit more people to buy its products," and said that this "would lead to greater production, increased employment and a higher annual wage for the laborer himself." He also said:

The objective we should all strive for is an economic system under which commodity prices, the wages of labor, prices for manufactured goods and farm prices are kept in such relation to one another as to permit the widest possible exchange of goods and services by all. * * * We must never forget that the only way to raise the standard of living and to increase the national wealth is through greater production and use of goods.

Mr. O'Neal also gave a broad interpretation of the farm demand for "parity prices":

Agriculture now has a law designed to give farmers parity position with other groups, but I am frank to say that I don't believe it will be possible for us to reach and maintain parity position for any considerable length of time, even with the help of this law, unless this problem of economic balance between groups is solved. There is a limit to the price which consumers will pay for food and fiber.

I am quite frank to say that, in my opinion, we never can solve the problem of unemployment in a democratic way except as the different groups unite on a coordinated program which, in effect, will provide for parity for all three groups.

Secretary Wallace told the Institute that with a population 8 per cent greater than in 1929, the country ought to have a national income around 90 billions, and added

I think we should drive all our efforts at a national income of not less than 100 billion dollars.

The Secretary also said that farmers, "if they are wise," would insist that "the first objective of agriculture, labor and business cooperation

with government ought to be an increase in the total production of wealth."

Opposing Views

These quotations are alike in showing that people are thinking gravely upon present conditions. Discontent and anxiety are manifested, but the conference addresses are conflicting, at least in emphasis.

Secretary Wallace and Mr. O'Neal are for driving ahead for a national income of $100,000,000,000 per year, which can be had only by the production of tangible wealth, and saving part of the increase to aid a further increase. Secretary Perkins and Mr. Hillman lay emphasis rather on shorter hours and more pay for low-income groups.

Mr. O'Neal says that an ideal condition would be if all wages and prices were "kept in such relations as to permit the widest possible exchange of goods and services," and this should be accepted as common ground.

It is true that Secretary Wallace and Mr. O'Neal are advocating governmental restriction of agricultural production, but only to restore the "parity" between agricultural products and industrial products. Secretary Perkins and Mr. Hillman also say that they advocate wage and hour regulations only until every would-be worker has a job at a "living wage." Remaining to be settled are perplexing questions as to the proper parities between services of all kinds in terms of wages, hours and prices. By whose wisdom are they to be fixed and maintained?

The Parity Idea

The parity idea, as presented by Mr. O'Neal at Des Moines, is winning favor. The Iowa Farm Bureau Federation gave it a fine endorsement at its annual meeting in December. It declared:

> We are willing to pay parity interest rates to capital, parity wage rates to labor, parity commissions to finance and fee paid professions, parity prices to industry, and parity tax rates and parity salaries and wages to all employes of government. * * * We make this offer because we believe through parity prices, and that alone, can we have security and stability for capital, labor, finance, industry, agriculture, government and the individual everywhere.

The Kansas State Board of Agriculture, in January, adopted a similar resolution, closing with the declaration that

> only by the free exchange of goods and services among groups, on a fair price and income basis, can we hope to achieve and maintain prosperity. **America needs an economic balance which will assure security for labor, stability for industry and parity for agriculture.**

The parity idea as defined in these resolutions and by Mr. O'Neal is sound in principle. It means that the highest state of general prosperity is had when the economic system is in balance throughout, with employment full, production at capacity, wages and prices so justly related that the varied products pay for each other and no troublesome surpluses pile up from year to year. These conditions, however, are not fixed and permanent. The system itself changes continually in methods, equipment, products and personnel. Agriculture is subject to the weather. Evidently a degree of instability is inherent in a highly organized, changing and interdependent economic system. Moreover, the natural wants and ambitions of men incline them, as individuals and as a group, to overestimate their contributions to the common supply and to contend for a larger share, with the result that the system becomes unbalanced and slows down with injury to all.

For example, it is now generally understood that certain groups of organized labor overtraded in early 1937. Labor costs increased rapidly at a time when many people were out of work, and this narrowed markets and made products less available to large numbers of consumers. Similarly, industry, to a degree, over-traded in raising prices, in many instances, more than was required by increasing costs, and thus contributed to the limitation of the market.

Also, the farm group, in pressing for farm legislation, fixed parity prices that were too high, with the result that they could not be maintained and the farmer, because of the attempt to maintain them, has lost an important part of his foreign market, notably in cotton. The idea of parity, embodied in farm legislation, was based on the period just before the war, one of the most prosperous periods for agriculture this country ever knew, apart from war booms, and no allowance has been made for greatly increased farm efficiency. The experience has illustrated the difficulties and dangers in fixing parities that are practicable and will work.

Moreover, it must be remembered that outside of these organized groups is a large portion of the population in trade and the services and in the professions, who are not part of organized groups; and if organized groups push the price of their wares and services beyond reach of these other groups, the economy will get out of balance, trade will slow down and all will suffer.

For these reasons the parity idea, while essentially sound, is difficult to embody in sound legislation and sound procedure. There is no easy remedy for this save increasing awareness of the problem by all groups and their greater mutual understanding.